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AN ELASTIC CREDIT CURRENCY AS A PREVENTIVE OF PANICS

BY WM. BARRET RIDGELY,
Comptroller of the Currency.

The commercial and financial conditions existing not only in the United States, but throughout the world, in the early part of October, 1907, which made a panic or crisis possible, were the accumulated and composite results of the business transactions of many years. A reaction in business was due and inevitable, in fact, it had for some time been in progress. The exact incident which precipitated the crisis and produced a panic, is not very material. If it had not been the collapse of the corner in United Copper stock, it might have come from the Westinghouse receivership a few days later, or from almost any one of a number of similar developments which were not only possible, but probable.

The expansion of business and inflation of credits, whether based on transactions which would be classed as perfectly sound and legitimate, or on semi-speculative ventures, or on speculation pure and simple, had reached the point where there had to be some settlement and liquidation. While it might not be difficult to assign any single transaction to one of the before-mentioned classes, it is impossible to separate the results on the general business situation and say just which added to and produced the catastrophe and which did not, how much was due to legitimate enterprise and how much to speculation. The time had arrived when some one had to pay the penalty for the indulgences of the past. The reaction and liquidation were not only absolutely inevitable, but necessary and desirable, in order to bring business of all kinds back to its normal condition. This should have been accomplished, however, in a much more orderly, quiet way, as it had been taking place for months, without the resulting excitement and foolish sacrifices incident to any condition of panic.

There never is any necessity for a panic and this, of all others, should never have taken place because the conditions did not justify it in any way. Least of all, should we have had a

panic among the banks, and this particular panic might easily have been avoided. In its place we might have had a more reasonable and orderly readjustment of credits and values if we had had a better system of currency and a better system of banking, both national and state. A better system, I say; not better banks.

We would also have been in a very much better position if the relations between the business world and the Treasury Department had been on a different basis: if the Treasury Department had been either entirely out of business and free from responsibility as to business conditions, as it ought to be, or if, being in business, it had had the proper facilities to deal with the situation as it arose.

I have no criticism to make of the operations of the Treasury Department, but on the contrary, from my experience during the three administrations of Secretaries Gage, Shaw and Cortelyou, I believe they are all entitled to the highest praise and commendation for what they have done to make the best of bad situations, with antiquated, complicated and cumbersome facilities, often little better than mere make-shifts.

Mr. Cortelyou, for instance, has done splendid work in the relief he has rendered in the last few trying weeks, by distributing government deposits and stimulating bank circulation, when it was so desperately needed. He has shown himself to be a strong, courageous, resourceful man, in a great crisis, and is entitled to all credit for it. The deposits of the government with the banks, have been very potent in checking the panic and restoring confidence, and on this account we find many men commending such a system of government finance. It is true the most has been made of it, and it has been done with not only fine ability, but with absolute fairness, with no end in view but the public welfare. But look at the situation. The United States Government has collected from its people \$245,000,000 surplus, above its necessary expenditures, and in order to restore this money to circulation and repair the damage done to business by its withdrawal, has had to deposit \$222,000,000 with the national banks; and when the supply of government bonds gave out, has had to accept various other bonds as security.

This is all that could be done under the circumstances, but the surplus should never have been collected to such a vast sum. The government should not take money from you and me when we

need it, just to keep it on hand as a panic fund. It is no proper governmental function to tax people for such a purpose. If it is conceded that the government should take a hand in such business, what an awkward, complicated method it has of doing the business. What a wasteful use of the money available.

The government should collect its revenues and make its payments as every one else does, through regular banking channels. The money should stay in the banks and the smallest possible amount should be withdrawn from circulation. If the national banks are not satisfactory for such use, we should have a central governmental bank to do the government business. The funds left in its hands would be available for use by the other banks for business of all kinds, either as reserves against circulating notes issued, or as loans and rediscounts to the banks. With such facilities as this at its command, the Treasury Department could prevent panics and keep business steady, instead of only being called in like a doctor to see a patient after he has become desperately ill. What we need is better hygienic and sanitary conditions and less medicine. The whole system is wrong, and requires change and readjustment.

While we are yet probably too close to the incidents of this panic to be able to properly judge of the causes and effects, we may now, while these matters are fresh in our minds, and their results have been brought home to us with such force, take account of those things which have made the trouble, and at once begin to devise means not only to repair the damages done but, much more important, to foresee the future, and make provision on proper principles for such changes as will avoid such troubles, or mitigate the effects of the disturbances which cannot be prevented.

It is needless to go into details as to the events which produced the business conditions existing in the United States for the last six months or a year. Everyone is familiar with the great expansion in business of every kind which has taken place all over the world. Probably the most potent factor in all of this, if it is not the sole cause of it, has been the enormous increase in the production of gold, which has more than quadrupled in the last few years, and is now at the rate of about \$430,000,000 per year. It is this, more than anything else, that has more than doubled

selling prices of wheat, corn, cotton, pig-iron, steel, copper and all the great staple articles of wealth which are the basis of all modern commerce. While this was going on, it was absolutely inevitable that there should be a great increase in the volume of credits not only in all the banks, but between merchants and manufacturers, between wholesale merchants and retail merchants and so on, through all the lines of business transactions. There is no country in the world, and no line of business, which has been free from it. It has led to an increase of what may properly be called legitimate investment values not only in mines, manufactures, and mercantile concerns, but in real estate of all kinds; city and suburban lots, farms, and tracts of timber. It has increased the prices of not only sales and transfers of the actual properties themselves, but of mortgages, stocks and securities based on them.

It is not only natural, but probably inevitable, that all this expansion should be overdone, for side by side with the transactions of men who are making such investments carefully and conservatively, based on real values, were those of men who, some through lack of judgment and over confidence, and others through dishonesty, were promoting schemes and issuing securities based on far higher values than were justified. This universal process of expansion and increase of values has been, on the whole, based on sound conditions and justified by the facts, but it has been evident for several years that we were approaching the crest of the wave, and there must be some slackening of pace and almost inevitably some reaction or decline in prices.

It must be remembered that this expansion started from the abnormally low values and basis which had followed the crisis and depression of the year 1893, and the few years following. Wealth at that time was measured on an abnormally low plane of values. It was not only perfectly proper, but highly desirable, that they should be increased. This has gone on, however, as events have shown, until the limit has been reached. The natural limit of all such movements is the amount of reserve money which can be held by the banks as the basis of their credits. The proportion of this has been growing less and less for several years, and for at least two or three years there has been a condition of scarcity of reserve money not only in the United States, but in all other countries.

Another important factor, and in some respects the most important, is that such an enormous proportion of the existing credits has been transformed from liquid capital into fixed capital and investments, leaving a scarcity of liquid capital for the enterprises which were in operation. It has been this, more than anything else, probably, which has led to the necessity for a contraction of credits and more or less liquidation.

During this whole period of active business, there have been many times when conditions have brought about violent reactions in the stock market. There have been several stock market panics, notably such as the one which occurred March 9, 1901, any one of which might have produced a far more serious bank panic than that which occurred in October, 1907, if business conditions had not been found so entirely sound that the disturbance was practically confined to the stock market alone.

During the past few years there have been several periods of marked depression although they have not been of long duration, nor accompanied by any considerable number of failures. Why, then, should we have had a banking panic of great severity in October and November, 1907? It cannot be that it was entirely due to speculation, for this existed in much less volume when the panic occurred than it has in several other periods when it produced stock-market panics. The more speculative loans were far less in volume in October, 1907, than they were a year ago. The main difference in the situation must have been that we were one year farther along in the period; that the whole world had come to realize that there had to be a readjustment; that many of the largest and strongest concerns, as is well-known, found difficulty in renewing their old loans, and foresaw that they were soon to be compelled to reduce the volume of their operations.

Conditions during the summer of 1907 were becoming more and more acute, and were greatly strained when the demand came for the crop-moving funds. The total volume of credits was up to the maximum that could be carried on the reserve money available. When the withdrawal of deposits in the demand for crop-moving money came, it was necessary for the banks to supply this with reserve money. As far as this money had to go into circulation outside the banks, it made a reduction in loans to that extent inevitable.

If our system had been such that the country bank first, then the reserve city bank, and finally the central reserve city bank, could have supplied some form of credit notes in payment of their deposits, the situation would have been entirely different. If we had had such a system of notes as they have in Canada, for instance, which expands quickly and automatically in the fall of every year, when this demand comes, and contracts just as surely by February of each year, there need have been no apprehension in regard to the crop-moving period. There would have been no variation in the volume of credits at all. Reserve money in the banks, which was ample for the deposits, would have been ample for the credit notes, if they had been available.

It need have made no difference at all in the total volume of credits. The total of note credits and deposits would have remained the same with the same reserve against them. No one need have cared how much the people changed their credits from one form to another, and there would have been no panic among the bankers as to the effect of a demand for current cash. There need have been no disturbance of payments, collections, or remittances. People who were insolvent or too badly extended might have suspended or failed, but the man who was in good solvent condition need not have been fearful, least of all panic-stricken..

Instead of this every banker was at once compelled, in self-defense, to increase the amount of cash on hand. That is, instead of maintaining his reserve at practically the same point and changing his deposit credits into note credits, he had to meet his deposit credits in reserve money, and to call upon his reserve and central reserve agents for it. When a demand of this kind came suddenly upon the country it was not surprising to find that deposits which had been counted on as reserves were not reserves at all because they were not available. This developed at once the two inherent weaknesses and defects in our banking system; the lack of any elasticity or expansibility of the currency, and the uncertainty of the system which piles reserve on reserve, first in the reserve cities and then in the central reserve cities.

The way to cure this trouble and prevent recurrences of events of this kind, is to give the banks and the people who are their depositors some proper system of elastic credit notes and to compel banks to carry against these notes and their deposits, larger reserves

in cash on hand, and keep their reserves in other banks where they will surely be available.

The experience of all the rest of the world, in every important country, has shown that the best way to accomplish this result is by means of a strong central government bank which will handle the finances of the general government, act as reserve agents for other banks and have the sole right to issue credit bank notes. This bank should be under government control, and subject to severe government supervision and inspection.

Among students of these problems the opinion is steadily growing that until something of this kind is done in the United States, we shall never have such a financial system as we should. With such an institution as this in operation, there could have been no excuse at all for such a panic as occurred this fall. Months ago, a central bank could have brought about such a gradual contraction of loans, and such reduction in the volume of business, as would have enabled us to meet this situation quietly and calmly without anything approaching a panic. Speculative corners might have collapsed, trust companies with large lines of commercial deposits unprotected by reserves, and invested largely in speculative ventures might have failed or have been liquidated, manufacturing concerns with inadequate capital attempting to do too large a volume of business with borrowed money might have been forced to suspend or submit to receiverships, mercantile concerns which had been able, through note-brokers, to dispose of such a volume of notes that their failure to renew brought on embarrassment might have been tided over and given extensions;—all without any bank panic if we had only had the advantage of a great public bank. The people who are engaged in smaller lines of business would thus have been spared the losses and embarrassments due to such conditions as have existed within the last few weeks.

As long as modern business is conducted on credit, as it must be, there will inevitably be periods of expansion and inflation which are inevitably followed by periods of liquidation. No one has ever suggested any means by which this can be avoided. With the knowledge that such conditions must exist, it is the highest duty of the government to provide proper means for dealing with them. Until this is done, we have only ourselves to blame for such a panic as has occurred within the last few weeks. It is

useless to blame it to speculation. It will not cure the evil to prohibit speculation in grain futures, or trading in stocks on margins. These are all only incidental to the great movements which we have been tracing. They do not cause the expansion of business, and do not bring about its collapse. It is still more unjust to blame such a condition upon the national administration, the acts of the legislative authority, or of the administrative officers.

Nothing can be more unfair and unwarranted by the facts than the efforts of his enemies and critics to put the blame of this panic on President Roosevelt. He is in no way to blame for the general conditions which were world-wide and far beyond the power of any man to prevent. He is not in the least responsible for the special incidents which started the feeling of panic among the banks, and led them to go to clearing-house certificates and a partial suspension of payments. There is far more blame due to those critics of the President who, for months before there was any condition approaching a panic, seized upon every remark made or action taken by him, and predicted its disastrous effect on business.

If this panic is in any way due to talk and prediction, the President's critics have done their utmost to produce it by their doleful lamentations and pessimistic predictions of what would happen if the President did not change his policies in regard to the enforcement of the laws. It is significant that the trouble started, and has been worst, in New York, where there has been the most criticism and abuse of the President and where he is supposed to have the most opposition. There has been less panic and trouble in the country, in the West, and among the smaller business men and the working people where the President has always been the strongest, and where anything he has said or done would surely have the greatest effect.

This whole episode has been more a panic among banks and bankers than among the people. Except in the City of New York, there has been surprisingly little excitement among the people, and very little distrust of the banks. That there have been so few failures and that the panic has been no worse, has been due to the intrinsically sound condition of the banks and the business of the country, to the wonderful courage, patience and forbearance of the business men and people. They have quickly adapted themselves to the necessities of the situation, and availed themselves

of every possible temporary expedient to get along until the excitement was past. This has been especially true of the working people and the smaller depositors, who in many notable instances, have acted in concert with great coolness and deliberation, to support their local banks and to share their portion of the burden.

The critical period has passed with surprisingly few failures. Conditions are improving daily; banks are resuming payments and remittances, and the panic is a matter of history. We have yet to face some depression in business, and have to undergo the somewhat painful, but very necessary process of reducing expenses, practicing economy, and paying our debts. But there is nothing that pays an individual or people better, and when matters are readjusted, and prices are on a better and more stable foundation, no one who knows our country and people, our resources and powers of recuperation, can doubt that in a short time our business will again proceed on a sounder and more durable basis. Our prosperity, while less spectacular and sudden, perhaps, will be greater than ever before.